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No. 199

In the Supreme Court of the United States

OCTOBER TERM, 1930

ROBERT H. LUCAS, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

SAMUEL F. HOUSTON

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, AND BRIEF IN SUPPORT THEREOF

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No. ——

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v.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, AND BRIEF IN SUPPORT THEREOF

PETITION

The Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Third Circuit entered in the above entitled cause on March 14, 1930 (R. 101), reversing the decision of the United States Board of Tax Appeals. (R. 25–28.)

STATEMENT

This case reached the Circuit Court of Appeals for the Third Circuit on the petition of Samuel F. Houston, respondent herein, for a review of the

decision of the Board of Tax Appeals determining a deficiency in respondent's income tax for the calendar year 1920.

The facts as found by the Board of Tax Appeals are as follows (R. 18–24):

The respondent was a stockholder and director of the Real Estate Trust Company of Philadelphia, a banking institution. The Trust Company closed its doors in the year 1906, and on August 28, of that year, George H. Earle, Jr., was appointed receiver. The financial embarrassment of the Trust Company was brought about by the improper conduct of its affairs by its president, Frank Hipple. Hipple loaned excessive amounts to one Adolph Segal, and took therefor collateral which could not be easily liquidated, but which was not without value.

The receiver for the Trust Company evolved a plan for reorganization which included as one of its provisions the creation of a fund of $2,500,000 from subscriptions by directors of the company. The company was to be given the $2,500,000 outright, and the subscribers were to be reimbursed, if at all, by all of the excess over $3,000,000 which might be realized from the "Segal Matters." This plan of reorganization became effective, and the subscribers to the $2,500,000 fund made their subscriptions with the understanding that if, from the administration of the "Segal Matters," $3,000,000 should be realized, the subscribers were to receive any excess over this amount which might be realized from the same. No restrictions or time limits

were placed upon the Trust Company in regard to its administration and final disposition of the assets available to the Trust Company in the "Segal Matters."

The Trust Company resumed business on November 1, 1906, and thereafter and until December 30, 1920, the "Segal Matters" were administered exclusively by it under the direction of George H. Earle, Jr., formerly receiver and thereafter president of the company.

The respondent contributed $755,000 to the fund. Of this amount he contributed $305,000 personally, and the balance was contributed on behalf of his mother and his sisters.

The respondent, at the time he subscribed to the guaranty fund, believed that the "Segal Matters" had considerable potential value, which, under Earle's administration, could be converted into a sufficient amount of cash to repay the subscribers the amount of their subscriptions with interest, and possibly some profit in addition. A suit against the American Sugar Refining Company under the Sherman Antitrust Act was contemplated on behalf of the Pennsylvania Sugar Refining Company, and the value of the "Segal Matters" depended to some extent upon the successful prosecution of such a suit. Suits were brought for $10,000,000, and in January, 1910, the litigation was compromised upon the delivery to the Trust Company, by the American Sugar Refining Company, of certain

bonds wrongfully withdrawn from the Trust Company, among which were bonds of the Pennsylvania Sugar Refining Company. The Trust Company afterwards converted the latter bonds, through a foreclosure, into 7,268 shares of stock in a reorganized company, thereafter called the Pennsylvania Sugar Company. This was on or before January 22, 1912.

Some question arose between the parties in regard to their rights under the subscription agreement, including the right to interest, and on May 5, 1916, a supplemental agreement was entered into. At this time, and for some time prior thereto, the principal unliquidated asset of the original "Segal Matters" was the 7,268 shares of stock in the Pennsylvania Sugar Company, and under the supplemental agreement it was provided that when this stock was disposed of the contributors to the guaranty fund should receive one-fourth of the proceeds.

In the latter part of 1920, the parties concerned, after full investigation, concluded that the liquidation agreement had rendered its maximum of service, and that the remaining Segal assets would not have any greater value during a substantial period of time in the future than they then had. Whereupon, the subscribers, either individually or by their duly constituted representatives, entered into separate agreements which as a group provided for complete liquidation of the "Segal Matters" by the

Trust Company. Distribution of one-fourth of the 7,268 shares of the Pennsylvania Sugar Company stock was made to the subscribers to the fund in proportion to the amount of their subscriptions in full satisfaction and discharge of their interest in the "Segal Matters." The subscribers never received any other return on their subscriptions.

The respondent entered into such an agreement on December 30, 1920, and on that date, in accordance with the terms of the agreement, received 548.734 shares of Pennsylvania Sugar Company stock. He personally was entitled to 222 of these shares. The remaining shares he received as the agent for his sisters and others who had subscribed through him.

At the time of such distribution, each share of stock of the Pennsylvania Sugar Company had a fair market value of $150.

At the end of 1920, the respondent wrote off his books as a loss $271,700, computed by deducting the value of the stock which he received from $305,000, the amount of his subscription. In reporting his income for 1920, he deducted this amount as a loss.

The Commissioner of Internal Revenue disallowed the deduction and found a deficiency in tax of $191,830.53. The respondent appealed to the Board of Tax Appeals. The Board sustained the action of the Commisioner, holding that the loss, if any, would be the difference between what was received in 1920 for the property right and its cost

or March 1, 1913, value, whichever was lower, and that since no effort was made by the respondent to show the March 1, 1913, value of the right in question, no deductible loss was established. The respondent filed a petition with the Circuit Court of Appeals for the Third Circuit, for a review of the decision of the Board (R. 28), and on March 14, 1930, the Circuit Court of Appeals reversed the Board's decision, on the ground that the respondent's loss was the difference between the cost of the right in 1906 and the amount realized in 1920. (R. 94–101.)

SPECIFICATION OF ERRORS TO BE URGED

The court below erred—

1. In failing to hold that only those losses are deductible from gross income which are sustained after March 1, 1913;

2. In failing to hold that the ascertainment of the March 1, 1913, value was necessary for the purpose of apportioning the total loss between the periods before and after March 1, 1913;

3. In holding that the deductible loss was the difference between the cost of the taxpayer's property right in 1906 and the amount realized in 1920, there being no evidence that any portion of said loss had been sustained subsequent to March 1, 1913;

4. In failing to hold that the burden was upon the respondent to prove the March 1, 1913, value of

his property right to support a claim for a deductible loss;

5. In holding that under the facts in this case respondent was relieved of the necessity of establishing the March 1, 1913, value of his property right.

REASONS FOR GRANTING THE WRIT

1. The decision in the present case is in conflict with the decisions of this Court.

In *United States* v. *Flannery*, 268 U. S. 98, this Court held that March 1, 1913, is a controlling date because the statutory provisions regarding value on that date are a limitation upon the amount of the actual gain or loss that would otherwise have been taxable or deductible. In this case the lower court imposed no such limitation. It allowed all losses subsequent to 1906 to be deducted even though there was evidence to indicate that a substantial part of the loss had been sustained prior to 1913. (R. 86.)

In *Lucas* v. *Alexander*, 279 U. S. 573, this Court held that the purpose of ascertaining the March 1, 1913, value of property is to apportion the total gain which has accrued between the periods before and after March 1, 1913. Under the *Flannery* decision the same rule is applicable to losses.

In *Reinecke* v. *Spalding*, 280 U. S. 227, this Court held that the burden was upon the taxpayer to establish his right to a deduction disallowed by the Commissioner of Internal Revenue. The respond-

ent presented no evidence of the value of his right on March 1, 1913.

2. The decision in the present case is in conflict with the decisions of the Court of Appeals of the District of Columbia in *Ayer* v. *Blair*, 26 F. (2d) 547, and the Circuit Court of Appeals for the Eighth Circuit in *Holmquist* v. *Blair*, 35 F. (2d) 10.

In *Ayer* v. *Blair, supra*, a taxpayer advanced moneys to an insolvent corporation in 1908, and obtained a partial recoupment in 1920. The court held that the only loss deduction that the taxpayer could have in 1920 was the difference between the 1913 and the 1920 values of his claim to recoupment.

In *Holmquist* v. *Blair, supra*, the court held that the March 1, 1913, value of the taxpayer's property interests was a matter of evidentiary proof, and that, to show error on the part of the Commissioner of Internal Revenue, value on that date must be proved.

3. The question is of present importance in the administration of the tax laws. The Revenue Act of 1924 and subsequent Acts provide a different basis for measuring gains or losses on the sale or other disposition of property acquired prior to March 1, 1913, but the necessity of establishing value as of that date has not been removed.

Wherefore it is respectfully submitted that the petition should be granted.

THOMAS D. THACHER,
Solicitor General.

JUNE, 1930.

BRIEF IN SUPPORT OF THE PETITION

OPINIONS BELOW

The opinion of the Circuit Court of Appeals (R. 94) is reported in 39 F. (2d) 351. The findings of fact and the opinion of the Board of Tax Appeals (R. 18–27) are reported in 13 B. T. A. 279.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered March 14, 1930. (R. 101.) Jurisdiction is conferred upon this Court by Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Was it incumbent upon the respondent to establish the March 1, 1913, value of his property right acquired prior to that date, to support a claim for a deductible loss on the disposition of such property in 1920?

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1918, c. 18, 40 Stat 1057, 1060, 1066, 1067,—

SEC. 214. (a) That in computing net income there shall be allowed as deductions:

* * * * *

(5) Losses sustained during the taxable year and not compensated for by insurance

or otherwise, if incurred in any transaction entered into for profit, * * *.

SEC. 202. (a) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—

(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and

(2) In the case of property acquired on or after that date, the cost thereof; * * *.

Treasury Department Regulations 45 (1920 edition) as amended by Treasury Decision 3206, Cum. Bul. No. 5, July–December, 1921, p. 51—

ART. 1561. *Basis for determining gain or loss from sale.*—For the purpose of ascertaining the gain or loss from the sale or exchange of property the basis is the cost of such property, or if acquired on or after March 1, 1913, its cost or its approved inventory value. But in the case of property acquired before March 1, 1913, when its fair market value as of that date is in excess of its cost, the gain which is taxable is the excess of the amount realized therefor over such fair market value. Also in the case of property acquired before March 1, 1913, when its fair market value as of that date is lower than its cost, the deductible loss is the excess of such fair market value over the amount realized therefor. No gain or loss is recognized in the case of property sold or ex-

> changed (a) at more than cost but at less than its fair market value as of March 1, 1913, or (b) at less than cost but at more than its fair market value as of March 1, 1913. In any case proper adjustment must be made for any depreciation or depletion sustained. What the fair market value of property was on March 1, 1913, is a question of fact to be established by any evidence which will reasonably and adequately make it appear. * * *.

STATEMENT

The facts are stated in the petition for certiorari.

ARGUMENT

I

The Circuit Court of Appeals holds that the proper basis for measuring the respondent's loss was the difference between cost in 1906 and the amount realized in 1920, and in support of this view states (R. 100):

> While by force of statute and judicial decisions, March 1, 1913, is, in given instances, a critical date in computing income taxes, it is not in every instance a controlling date.

It is submitted that the ascertainment of the March 1, 1913, value of the property in question was necessary in order to apportion the total loss sustained between the periods before and after March 1, 1913. In *Lucas* v. *Alexander*, 279 U. S. 573, this Court said (p. 579):

> The purpose of ascertaining the value of the taxpayer's property on March 1, 1913, is, as Section 202 states, to measure that part of his total gain which has arisen or accrued after the enactment of any of the statutes taxing income and thus to arrive at his gain which may be taxed as income. *Lynch* v. *Turrish* [247 U. S. 221]. Value as of that date may be disregarded unless it serves that purpose. *United States* v. *Flannery,* 268 U. S. 98; *Goodrich* v. *Edwards,* 255 U. S. 527; *Walsh* v. *Brewster,* 255 U. S. 536.

And on page 580:

> Here, 1913 value is at most merely a method of allocating a known income to the periods in which it actually accrued. It is never necessary to speculate, as did the court below, as to what might later be realized from his property by the taxpayer, nor as to what might have been realized if, on March 1, 1913, he had made some forced disposition of the property which would have precluded any taxable gain. For the necessity of ascertaining value as of March 1, 1913, can never arise until some later date when income has been produced by converting the property into money or money's worth and the amount actually realized is known, and then, as we have said, only for the purpose of apportioning the total gain which has accrued between the periods before and after March 1, 1913.

Authority for applying the same rule to losses is found in *United States* v. *Flannery*, 268 U. S. 98, where this Court said (p. 103):

> These decisions [*Goodrich* v. *Edwards*, and *Walsh* v. *Brewster*] are equally applicable to the Act of 1918. * * * As it was held in these decisions that the Act of 1916 imposed a tax to the extent only that gains were derived from the sale, and that the provision as to the market value of the property on March 1, 1913, was applicable only where a gain had been realized over the original capital investment, so we think it should be held that the Act of 1918 imposed a tax and allowed a deduction to the extent only that an actual gain was derived or an actual loss sustained from the investment, and that the provision in reference to the market value on March 1, 1913, was applicable only where there was such an actual gain or loss, that is, that this provision was merely a limitation upon the amount of the actual gain or loss that would otherwise have been taxable or deductible.

The respondent, by making his contribution in 1906, acquired a right to share in the excess proceeds from the liquidation of the "Segal Matters"; this right was property in the nature of a chose in action; it was subject, as the lower court has said (R. 100), "to disposition through testacy, intestacy, and sale"; and it had a value which persisted throughout the fourteen years it had been held. In 1920, he converted this right into "money

or money's worth" having a value less than cost. Hence, if the amount realized was in excess of the March 1, 1913 value, no loss could be deducted, for the reason that the loss would be attributed to the period prior to March 1, 1913; or, if the March 1, 1913 value was less than cost but more than the amount realized, the deductible loss would be the excess of the March 1, 1913 value over the amount realized, for the reason that the loss attributable to the period prior to March 1, 1913, is not dedeductible. The basis used by the lower court to measure the loss in the instant case ignores the statutory limitation upon the amount of the actual loss which is deductible, and results in the erroneous allowance of a loss which may have been sustained prior to March 1, 1913.

II

The burden was upon the respondent to prove that he was entitled to the deduction disallowed by the Commissioner. *Reinecke* v. *Spalding*, 280 U. S. 227. It was necessary that respondent establish the March 1, 1913, value of his right in order to measure the loss sustained after that date. The respondent, however, relied upon a different basis for measuring the amount of his loss, and made no effort to show the value of his right on March 1, 1913. Difficulty in establishing such value did not relieve respondent of his burden. Cf. *Lucas* v. *Alexander*, *supra*, p. 579.

CONCLUSION

Because of the importance of the question involved in the administration of the tax laws and the conflict of decisions thereon, it is submitted that the petition should be granted.

Respectfully submitted.

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